

SECURITIES CONSUMER'S GUIDE

Prepared by the Commonwealth of Virginia
State Corporation Commission
Division of Securities and Retail Franchising



**STATE CORPORATION COMMISSION
DIVISION OF SECURITIES
AND RETAIL FRANCHISING**

The Virginia State Corporation Commission's Division of Securities and Retail Franchising prepared this guide as a helpful tool for anyone considering to invest in securities. Investing in securities is one of the traditional choices people make to prepare for their financial future. Investments are not, however, without unforeseen risks and dangers. Use this brochure to help you recognize those risks and make wise investment decisions.

The division staff is available to the public. If you have questions about a broker-dealer, investment advisor, or agent, or if you want to know if a particular security is registered in the Commonwealth, call (804) 371-9051 or toll free in Virginia only (800) 552-7945. Persons with a hearing impairment may use the SCC's Telecommunications Device for the Deaf (TDD) by calling either the toll free number or (804) 371-9206.

If you think you have been a victim of securities fraud or of an unethical broker-dealer or investment advisor, describe your concerns and the events of the transaction in a written complaint and mail it to the Virginia State Corporation Commission, Securities Division, PO Box 1197, Richmond, VA 23218.

I hope you will find this guide helpful.

Ronald W. Thomas

Ron Thomas
Director

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VIRGINIA STATE CORPORATION COMMISSION DIVISION OF SECURITIES AND RETAIL FRANCHISING

The mission of the Securities division is to protect consumers through the administration and enforcement of the Virginia Securities Act. The division meets that responsibility by requiring those persons transacting securities business in the Commonwealth to provide investors with full and complete disclosure about the securities offered and to conduct their activities in an ethical manner. Attention is focused in four areas:

Securities Registration

Examining securities issues is one of the keystones of the division's mission. This function helps ensure that firms offering securities in Virginia adequately disclose information relevant to the investor. Although many securities are exempt from registration in Virginia, those exemptions are normally based on generally accepted standards or on the basis of a prior review of the security. For example, stocks listed on the major stock exchanges are exempt from registration. However, a significant number of stock offerings, limited partnerships, oil and gas ventures, etc., must pass a review by the division staff before they can be offered to Virginia investors. The staff review process evaluates such areas as the financial solvency of the issuer, possible abuses by insiders, and the accuracy of information about the offering. The key point to remember is that we strive to ensure the offering complies with the requirements of the State law, but we do not approve or in any way endorse a particular security as a good investment. The investor is responsible for deciding, based on a personal review and analysis, if the offering is a *good* investment.

Broker-Dealer and Agent and Investment Advisor and Representative Registration

A broker-dealer is any firm that participates in the offer and sale of securities. An investment advisor is any firm that pro-

vides the public with investment advice related to securities for compensation. The Virginia Securities Act requires all broker-dealers and investment advisors transacting business in Virginia to register with the division unless an exemption or exclusion exists. In addition all broker-dealer sales personnel (“agents”), and all investment advisor personnel providing investment advice to the public (“representatives”) must also register with the division. Registrants must conduct their activities in an ethical manner according to rules established by the Commission. They also must pass certain examinations. Firms that fail to comply with the provisions may face sanctions and in some instances be prohibited from conducting their securities business in Virginia.

Registered Broker-Dealer and Investment Advisor Practices

The division conducts periodic audits of broker-dealer and investment advisor activities. A typical audit reviews a sample of nearly every aspect of the broker-dealer’s or investment advisor’s activities with particular focus on sales practices. The division also investigates investor complaints about the practices of registered broker-dealers and investment advisors.

Unregistered Broker-Dealer, Investment Advisor, and Securities Investigations

Despite the fact that most securities, broker-dealers, investment advisors and their agents and representatives must register with the division, scam and con artists exist and ignore the law. Sometimes even reputable businesses fail to properly register themselves or the securities they offer for sale. The division’s enforcement section investigates investor complaints related to fraud, unregistered broker-dealers, unregistered investment advisors, and unregistered securities.

HOW CAN WE HELP?

The division does not give investment advice or make recommendations. However, listed below are a few suggestions that may help you be a better informed investor.



SELECTING A BROKER-DEALER OR INVESTMENT ADVISOR

Match your needs with Firm Services

Selecting a broker-dealer may be a very big decision for you, depending on your level of experience. Seasoned investors may find the limited services of a discount broker-dealer to their advantage. Others may opt for a full service broker-dealer or the services of an investment advisor.

A full service broker-dealer provides a wider range of services than a discount broker-dealer. The full service broker-dealer usually conducts market research, and a sales agent assigned to your account will be available to offer you advice on which investment products to purchase. They may also offer financial, estate, and tax planning services, as well as managed accounts. Although fees may be higher with a full service broker-dealer, the new investor may find the added services valuable.

Discount broker-dealers usually just execute trades. As a general rule, they do not conduct any market research for the investor's benefit nor do they make recommendations or provide investment advice.

Investment advisor services may go beyond just offering advice on which securities to buy. The type of services they offer varies widely, but they usually provide an analysis of your financial situation and develop a financial model for you to follow as your investment strategy. Many investment advisors will also provide or recommend broker-dealer services for you to implement your financial plan.

Regardless of the type of financial service you choose, it is important to do some background research on the firm and the agent or representative. Look for the following:

Registration & Disciplinary History

The division can tell you if the firm, agent or representative is properly registered in Virginia. If the firm is registered, the division can also provide information about any recorded disciplinary history.

Investment Advisor

Ask to see Form ADV Part I, which details any history of regulatory problems. Demand to see Form ADV Part II, which outlines the advisor's experience and practices.

Sales Agent or Investment Advisor Representative

Talk with the people who will handle your account. Ask them about their investment experience, professional background, and education.

Fees & Charges

Ask for a copy of the firm's commission schedule and learn what fees and charges you will be required to pay when opening and closing an account. Understand how the firm compensates their agents. Firms generally pay sales staff based on the amount of money invested and/or the number and size of transactions. Selling the broker-dealer's own investment products sometimes earns the agent a higher commission. Some common types of fees you might expect include:

Account Management Fees. These can range from no fee at all to a set annual fee if your account fails to generate a certain level of commissions.

Front-End Loads. These are commissions paid to the broker-dealer and agent for selling mutual funds. Sometimes you can avoid the charge by buying directly from the mutual fund.

Back-End Loads. These are deferred sales charges that may decline over time. You pay the charge when you sell your mutual fund shares.

Management Fees. These are charged to investors to cover the management expenses of the mutual fund.

Wrap Fees. These are single charges for packages of services such as combined brokerage and investment advisory services. Unlike commission based fees, wrap fees normally are not related to the number, size, or frequency of transactions.

Securities Investors Protection Corporation (SIPC)

If your brokerage firm or investment advisor has custody of your securities, ask if they are covered by SIPC. SIPC provides some limited customer protection if a brokerage firm becomes insolvent. SIPC *does not* insure against losses attributable to a decline in the market value of your securities. For further information contact SIPC at 805 15th Street, N.W., Suite 800, Washington, D.C. 20005-2207, or call (202) 371-8300.

CONCENTRATE ON THE NEW ACCOUNT FORM

After you choose a broker-dealer or investment advisor, one of your first meetings with the agent or representative will involve preparing a new account form. This form is important because it involves you in making three critical decisions, and describes any compulsory arbitration requirements.

1) Financial Profile

During that first meeting with your new broker-dealer or investment advisor, your agent or representative will help you to develop your financial profile. He should ask you a series of questions regarding your income and assets, your career and retirement plans, and the degree of risk you are willing to take in investing.



It's important to take some time to determine your risk tolerance, i.e., your ability to accept the worst case investment scenario — a loss. Like all things in this world, there are trade-offs. Everybody wants a profit, but losses **do** occur.

Your ability to sustain a loss depends on your wealth and your investment strategy. All financial instruments have a degree of risk. Instruments that lack risk will generally have proportionally less reward. Conversely, high risk opportunities may have higher rewards. Most investors' needs fall somewhere between the two extremes.

When you talk to your investment advisor representative or broker-dealer agent, tell that person how you feel about risk, so he can select investment opportunities that are appropriate to your risk level.

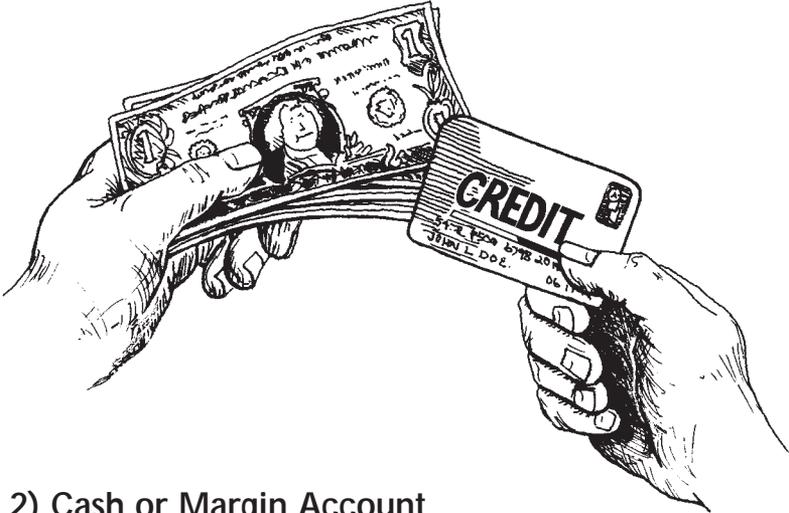
Ensure that the financial profile shown on your new account form accurately reflects your investment objectives, and keep a copy for your records. If your investment strategy changes over the years, be sure that your records accurately portray your revised objectives. Some typical categories for investment objectives are:

Safety. A conservative investment approach with only modest risk and only a modest expected profit.

Income. Also a fairly conservative investment approach designed for immediate income as interest or dividends.

Growth. A more risky investment approach designed for growth over the long term.

Aggressive Growth or Speculation. A very risky investment approach intended to achieve high profits. Since you may lose your entire investment, use this method only if you are a sophisticated investor.



2) Cash or Margin Account

Your broker-dealer will also ask whether you want to open a cash or margin account. Cash accounts are the most common and require that you pay for transactions in full. The alternative is a margin account that allows you to buy securities by borrowing money from the broker-dealer. Buying securities on margin can mean greater profits, but those profits must exceed the margin borrowing expenses in order for the investor to profit. Buying on margin also involves greater risk because you must pay the broker-dealer for any margin loss. You might be forced, with or without your input and contrary to your investment goals, to liquidate other securities in your portfolio. The loss could even extend beyond the value of securities in your account. Understand the principles and the risks completely before trading on margin.

3) Discretionary Account

You decide what investments to make unless you give the agent or representative discretionary authority. Complete dis-

cretionary authority allows your agent or representative to decide, ***without consulting you***, what securities to purchase or sell, when to buy or sell them, and how much to pay or accept for them. You forfeit control of your investments when you authorize discretionary trading, so consider the circumstances carefully before deciding if this arrangement is appropriate for you.

Resolving Disputes through Arbitration

Most broker-dealers now ***require*** their customers to agree to arbitration instead of going to court. The agreement is usually signed as part of the new account application. Read and understand the requirements of the agreement, as well as your rights and duties, because, depending on the nature of your complaint, you may decide to file an arbitration claim. The first step in that process is to determine the arbitration forum designated by the brokerage firm. Then, contact the appropriate forum and request a “demand for arbitration” packet. The packet should explain how to file your arbitration claim and provide you with all the information and documents you will need.

INVESTING YOUR MONEY

Know Your Investments

You are responsible for your investments, so research opportunities completely before you invest. If you are considering exchange-listed securities you can usually check business publications such as *Value Line*, *Moodys*, *Morningstar* or *Standard and Poors* to learn about the corporation’s past financial performance and operating history. Make sure you ask for and read the firm’s legally required offering documents and annual report. If you are considering an investment that cannot be re-sold on a listed exchange or in some other public market, your risks will be even greater and your research efforts should be proportional. Be aware that even “safe” investments may not be insured and you could lose your entire investment.



General Securities and Investment Products

Please understand that the descriptions of the following types of securities are only general guidelines. Many additional types of securities exist and each, including those listed, has variations. Therefore, your determination as to risk and suitability will depend on your analysis of all the factors related to each separate investment opportunity.

Certificates of Deposit (CDs) are negotiable securities issued by commercial banks against money deposited for them. They vary as to dollar amount and maturity. For CDs under \$100,000, the maximum interest payable is fixed by the Federal Reserve Board. They are usually recommended for investors seeking preservation of capital and safety and are guaranteed by the FDIC, subject to limitations.

Annuities are contracts providing for a specified income payable to an insured, at regular intervals over a certain period of time. They provide some capital appreciation and are usually recommended for investors seeking preservation of capital or safety.

U.S. Government Securities are negotiable debt obligations of various government agencies. Since they are guaranteed or

backed by the full faith and credit of the United States Government, they are usually recommended for investors seeking preservation of capital and income.

Municipal Securities are negotiable debt obligations issued by towns, cities, counties, etc., or other subdivisions of a state or municipality, which are backed by the good faith and/or taxing power of the municipality. They are usually appropriate for investors seeking predictable income and moderate safety. Characteristics to consider for these securities are the issuer's financial capabilities, debt rating, and whether the securities are backed by the taxing power of the municipality.

Money Market Funds are mutual funds that invest in short-term debt instruments such as U.S. Government Securities, bank CDs and other types of commercial paper. They are usually appropriate for investors who want immediate income, low risk and easy access to their funds.

Corporate Bonds are debt obligations of a corporation. They are usually appropriate for investors seeking income. These bonds are rated widely as to risk and quality. The ratings can be used to determine congruence with investor goals and suitability.

Common Stock represents a voting ownership interest in a corporation. Depending on the type and nature of the corporation issuing the stock, it may be recommended to investors seeking any combination of investment goals such as safety, current income, growth and speculation. Characteristics to consider are the corporation's earning and net worth, volatility of stock price, the nature of the corporation's business and whether the stock can be resold on one of the listed exchanges or in other public markets.

Preferred Stock represents a non-voting ownership interest in a corporation. Preferred shareholders usually receive fixed dividends that are senior to, and payable before, any common stock dividends and they may also have preference in the distribution of assets. Preferred stock is normally recommended for investors seeking income. However, like common stock, it may be suitable for other investment strategies depending on the characteristics of the corporation.

Mutual Funds are investment companies that make investments on behalf of individuals and institutions who share common financial goals. The suitability of a particular mutual fund for an individual investor depends on the type and nature of the fund's investments and amount of diversification. Funds are rated widely as to risk and return, and such ratings can be used to establish congruence with investor goals and suitability.

Derivatives are contractual relationships established by two or more parties where payment is based on or derived from some specific or multiple standard. Therefore, the only limit to the types of derivative products is the realm of human imagination. Common derivative products are futures, options, forward contracts, stripped mortgage-backed securities and structured notes. Derivatives are speculative in nature and generally suitable only for sophisticated investors.

Real Estate Investment Trusts invest in real estate properties or mortgages. They are typically suitable for investors seeking capital appreciation and income. They are not generally suitable for investors seeking safety of capital and liquidity. Characteristics to consider in these types of investments are the amount leveraged, the program's track record of performance, size of the public market, and the organizer's experience, past performance and compensation (particularly amounts earned regardless of program earnings).

Limited Partnerships are a form of business organization operated under the management of a general partner. Limited partners have no responsibility for managing the partnership's operation and can normally be held liable only to the extent of their investment and any income received. It is generally difficult for investors to sell their interests in limited partnerships; therefore, they are not suitable for investors seeking liquidity and/or safety of capital. Characteristics of a limited partnership to consider are the amount leveraged, the general partner's experience, past performance and compensation (particularly amounts earned regardless of program earnings). Voting rights are also important because they can determine if and under what circumstances the limited partners can remove and replace the general partner.

Convertible Securities are securities bought with an investor right (usually conditional) to convert the securities to another form. For example, common stock purchased with rights to convert it to preferred stock at a later date, or debentures purchased with rights to convert them to common stock. Convertible securities are often issued to reduce the risk or increase the possible return of the initial issue. They are generally more suitable for sophisticated investors.



Monitor Your Securities

Review both your account statement and confirmation statements when they arrive to make sure new transactions were authorized and properly recorded. Notify your broker-dealer **immediately** if you suspect any discrepancies. Try to stay abreast of any news about your securities such as tender offers or call provisions that could affect the value of your securities.

Broker-dealers are required to provide a written confirmation to the customer for each transaction. As the customer, you must pay for a “buy” transaction within three working days from the trade date. If it is a “sell” transaction and you hold your securities in your own name, you must deliver those securities to the broker-dealer also within three working days.

Know Your Rights

- Your sales representative usually will only earn a commission when you make a trade. Encouraging you to make excessive trades is known as churning, and is prohibited.
- Broker-Dealers must execute your orders at or near the same price quoted when you placed the order, and they cannot withdraw funds or securities from your account without your written authorization.
- If a sales agent asks you to “Make that check payable to me” or tells you “That’s just an administrative error, I will take care of it” or any other statement that makes you uncomfortable, immediately call the branch manager or compliance officer for confirmation.
- Unless you sign a discretionary agreement, your broker-dealer must have your permission before conducting any trades in your account. Contact your broker-dealer immediately if any unusual trades appear on your account statement.
- Beware of high-pressure sales pitches, especially for inexpensive securities (generally under \$10). Reputable agents will appreciate your need for time to study any investment.

INVESTOR CHECKLIST

- Did I deal only with a registered broker-dealer agent or investment advisor representative?
- Do I understand all sales charges and other administrative fees such as surrender charges?
- Is the investment registered with state or national agencies?
- Did I identify my investment objectives, income, growth, safety, etc.?
- Do I understand the risk involved and how much of my investment I could lose?
- What information do I have about the officers, directors and other personnel of the company? Who are they and what is their experience and expertise?

- Where is the company located and what is the nature of its business?
- How long has the company been in business?
- What are the terms of the offering?
- What amount of equity ownership will investors have?
- Did I review a current financial statement of the company?
- Do I know for what purpose the company intends to use my money?
- What is the basis of the purchase price of the securities?
- Can I determine the value of my investment at any time?
- Will I be able to resell this investment whenever I please? How and where may I do this?
- Are there lawsuits or bankruptcies pending against the company or any of its officers and directors?
- Can I obtain a list of the names and addresses of other investors?
- What are the conditions for modifying or terminating the agreement by either party?
- Do I want my securities held for safekeeping by my broker-dealer, or do I want them made out in my name and sent to me?
- Am I fairly certain I will receive a return on my principal, or do I still need to do more research before I am fairly confident that I will even have my principal returned?



SECURITIES FRAUD

Investment schemes and frauds do exist within the securities industry. Promoters are quick to pick up on the newest hot investment prospects and the latest technology trends and use them as a basis for new investment schemes. Many of those schemes are very enticing and very difficult to spot. Almost all of them depend on trusting investors willing to believe the promoter's claim without question. It may be difficult to identify fraudulent schemes, but there are some things you can do to avoid becoming a victim.

- Deal only with firms and individuals you have researched and trust.
- Be skeptical of any investment opportunity that comes about as a result of an unsolicited telephone call or even a television advertisement. Never invest without doing some research about the opportunity. The Federal Communications Commission regulates telephone solicitations and automated calls under the Telephone Consumer Protection Act. Provisions of that act require the person making the call identify himself and the name of the entity on whose behalf the call is being made. He must also give you the telephone number where the person or entity may be

contacted. Other provisions require the entity to remove your name from its call list upon a written request and prohibit unsolicited calls between 9:00 p.m. and 8:00 a.m. Obtain additional information by contacting the Federal Communications Commission, 1919 M. Street N.W., Washington, DC 20554; or call (202) 632-7553.

- Beware of glowing promises of high returns. Ask yourself why the promoter is so eager to share the opportunity with you and remember that if it sounds too good to be true, ***it probably is***
- Carefully analyze promotions offering high returns by investing in the latest technology developments.
- Resist the temptation to invest “right now” because “Tomorrow will be too late.” Don’t be surprised if they follow that line by “We will have someone there within the hour to deliver the prospectus and pick up your check.”
- Never believe a salesperson when he says, “You don’t have to read the prospectus or contract. That’s just for the lawyers.”
- Be extremely careful about giving out your social security number, credit card or bank account information.
- Look for audited financial statements and review them carefully. Be leery of the absence of audited financial statements and scrutinize unaudited financial statements carefully because an expert third party has not attested to their accuracy. Question any financial statement projections to see if the expenses and profits appear reasonable.
- Always..always..always....read and understand the legally required offering documents, ask questions and insist on reasonable answers. Seek advice from a knowledgeable friend or consult with your financial advisor, and invest ***only*** after you have satisfied yourself that the risk in this particular investment agrees with your financial objectives.
- ***Save*** all records of transactions and correspondence. ***Never*** part with original documents.

- Take notes of your conversations with your broker-dealer agent or investment advisor representative. Include the dates and times.
- Slick promoters know how to make fraudulent investments sound legitimate and inspire your confidence. That is why they succeed so often. If you feel you have been victimized, report the matter to Division of Securities and Retail Franchising. You might also want to contact an attorney to determine your rights. Your prompt complaint may keep others from being defrauded and increase your chance of getting your money back.

RESOLVING DISPUTES

If a problem arises with your brokerage account or if you suspect any improper activity, immediately contact the branch manager. Address your complaint in writing and ask for a written response. Keep copies of all correspondence. If the branch manager does not respond to your complaint or if you do not feel the response is adequate, write to the firm's compliance officer. Notify the Virginia State Corporation Commission, Division of Securities if you continue to have a problem with the broker-dealer or investment advisor. Explain the problem and enclose copies of all correspondence with the broker-dealer and any notes or memoranda of conversations with the firm's agent, branch manager and compliance officer.

Depending on the nature of your complaint you may also want to contact one of the other securities regulators listed on the following page.

WHERE TO GET HELP

Virginia State Corporation Commission
Division of Securities
P.O. Box 1197
Richmond, VA 23218
(804) 371-9051

U.S. Securities and Exchange Commission
450 5th Street, NW
Washington, DC 20549
Office of Investor Education and Assistance
(202) 942-7040

North American Securities Administrators
Association, Inc.
Suite 310
One Massachusetts Av., NW
Washington, DC 20001
(202) 737-0900

National Association of Securities Dealers, Inc.
1735 K Street, NW
Washington, DC 20006-1500
(301) 590-6500

American Arbitration Association
140 West 51st Street
New York, NY 10020
(212) 484-4000